

AMENDED IN ASSEMBLY APRIL 14, 2005

CALIFORNIA LEGISLATURE—2005–06 REGULAR SESSION

ASSEMBLY BILL

No. 1628

Introduced by Assembly Member Klehs

February 22, 2005

An act to amend Sections 18662, 18666, and 18668 of the Revenue and Taxation Code, relating to taxation.

LEGISLATIVE COUNSEL'S DIGEST

AB 1628, as amended, Klehs. Taxation: withholding: penalty for failure to withhold.

Existing law requires a withholding agent, as defined, to withhold tax from payments of income derived from California sources and received by nonresident contractors, beneficiaries of estates and trusts, partners, and individual ~~resident~~ *residents* and nonresident sellers of California real property. Existing law imposes a penalty on a withholding agent for failure to withhold, calculated based on the amount of tax that the taxpayer failed to pay, not to exceed the amount that should have been withheld by the agent. Under existing law, the penalty can be assessed only after the Franchise Tax Board determines the amount of tax that the taxpayer failed to pay.

This bill would modify the current assessment procedure to permit the Franchise Tax Board to assess a penalty for failure to withhold immediately after a failure to withhold occurs and to base the imposition of that penalty solely on the failure of the agent to withhold rather than on the amount of tax owed by the taxpayer. This bill would also change the amount of penalty to the greater of \$500 or 10% of the amount required to be withheld, *and would treat a real estate escrow person as a transferee of a California real estate interest and would*

require that person to withhold, as provided, if she or he fails to notify the legal transferee of the withholding requirements.

Vote: majority. Appropriation: no. Fiscal committee: yes.
State-mandated local program: no.

The people of the State of California do enact as follows:

- 1 SECTION 1. Section 18662 of the Revenue and Taxation
- 2 Code is amended to read:
- 3 18662. (a) The Franchise Tax Board may, by regulation,
- 4 require any person, in whatever capacity acting (including lessees
- 5 or mortgagors of real or personal property, fiduciaries,
- 6 employers, and any officer or department of the state or any
- 7 political subdivision or agency of the state, or any city organized
- 8 under a freeholder's charter, or any political body not a
- 9 subdivision or agency of the state), having the control, receipt,
- 10 custody, disposal, or payment of items of income specified in
- 11 subdivision (b), to withhold an amount, determined by the
- 12 Franchise Tax Board to reasonably represent the amount of tax
- 13 due when the items of income are included with other income of
- 14 the taxpayer, and to transmit the amount withheld to the
- 15 Franchise Tax Board at the time as it may designate.
- 16 (b) The items of income referred to in subdivision (a) are
- 17 interest, dividends, rents, prizes and winnings, premiums,
- 18 annuities, emoluments, compensation for services, including
- 19 bonuses, partnership income or gains, and other fixed or
- 20 determinable annual or periodical gains, profits, and income.
- 21 (c) The Franchise Tax Board may authorize the tax under
- 22 subdivision (a) to be deducted and withheld from the interest
- 23 upon any securities the owners of which are not known to the
- 24 withholding agent.
- 25 (d) Unless it is shown that the failure to withhold is due to
- 26 reasonable cause, any person failing to withhold from any
- 27 payments any amounts required by subdivision (a) to be withheld
- 28 is subject to a penalty for each failure in the amount equal to the
- 29 greater of the following:
- 30 (1) Five hundred dollars (\$500).
- 31 (2) Ten percent of the difference between the amount withheld
- 32 and submitted to the Franchise Tax Board and the amount

1 required to be withheld and submitted to the Franchise Tax
2 Board.

3 (e) (1) This subdivision applies to any disposition of a
4 California real property interest by:

5 (A) Any person, other than either of the following:

6 (i) A corporation, including an entity classified for tax
7 purposes as a corporation under Part 11 (commencing with
8 Section 23001).

9 (ii) A partnership, as determined in accordance with
10 Subchapter K of Chapter 1 of Subtitle A of the Internal Revenue
11 Code, including an entity classified as a partnership for tax
12 purposes under Part 10 (commencing with Section 17001).

13 (B) A corporation, if the corporation immediately after the
14 transfer of the title to the California real property has no
15 permanent place of business in California. For purposes of this
16 subdivision, a corporation has no permanent place of business in
17 California if all of the following apply:

18 (i) It is not organized and existing under the laws of
19 California.

20 (ii) It does not qualify with the office of the Secretary of State
21 to transact business in California.

22 (iii) It does not maintain and staff a permanent office in
23 California.

24 (2) In the case of any disposition of a California real property
25 interest by a transferor described in paragraph (1), the transferee
26 (including for this purpose any intermediary or accommodator in
27 a deferred exchange) is required to withhold an amount equal to
28 $3\frac{1}{3}$ percent of the sales price of the California real property
29 conveyed.

30 (3) Notwithstanding any other provision of this subdivision,
31 all of the following shall apply:

32 (A) No transferee is required to withhold any amount under
33 this subdivision unless the sales price of the California real
34 property conveyed exceeds one hundred thousand dollars
35 (\$100,000).

36 (B) (i) No transferee (other than an intermediary or an
37 accommodator in a deferred exchange) is required to withhold
38 any amount under this subdivision unless written notification of
39 the withholding requirements of this subdivision has been
40 provided by the real estate escrow person.

(ii) *If the real estate escrow person fails to notify a transferee other than an intermediary or an accommodator in a deferred exchange, of the withholding requirements of this subdivision, the real estate escrow person shall be treated as the transferee and shall be required to withhold in accordance with this subdivision.*

(C) (i) No transferee, trustee under a deed of trust, or mortgagee under a mortgage with a power of sale is required to withhold under this subdivision when the transferee has acquired California real property at a sale pursuant to a power of sale under a mortgage or deed of trust or a sale pursuant to a decree of foreclosure or has acquired the property by a deed in lieu of foreclosure.

(ii) No transferee is required to withhold under this subdivision when the transferor is a bank acting as trustee other than a trustee of a deed of trust.

(D) No transferee (including for this purpose any intermediary or accommodator in a deferred exchange) is required to withhold any amount under this subdivision if the transferee, in good faith and based on all the information of which he or she has knowledge, relies on a written certificate executed by the transferor, certifying, under penalty of perjury, one of the following:

(i) (I) The California real property being conveyed is the seller's or decedent's principal residence (within the meaning of Section 121 of the Internal Revenue Code).

(II) The last use of the property being conveyed was use by the transferor as the transferor's principal residence within the meaning of Section 121 of the Internal Revenue Code.

(ii) (I) The California real property being conveyed is being exchanged, or will be exchanged, for property of like kind (within the meaning of Section 1031 of the Internal Revenue Code), but only to the extent of the amount of the gain not required to be recognized for California income or franchise tax purposes under Section 1031 of the Internal Revenue Code.

(II) Subclause (I) may not apply if an exchange does not qualify for nonrecognition treatment for California income or franchise tax purposes under Section 1031 of the Internal Revenue Code, in whole or in part, due to the failure of the transaction to comply with the provisions of Section 1031(a)(3)

1 of the Internal Revenue Code, relating to the requirement that
2 property be identified and that the exchange be completed not
3 more than 180 days after the transfer of the exchanged property.

4 (III) In any case where clause (ii) applies, the transferee
5 (including for this purpose any intermediary or accommodator in
6 a deferred exchange) is required to notify the Franchise Tax
7 Board in writing within 10 days of the expiration of the statutory
8 periods specified in Section 1031(a)(3) of the Internal Revenue
9 Code and thereafter remit the applicable withholding amounts
10 determined under this subdivision in accordance with paragraph
11 (4).

12 (iii) The California real property has been compulsorily or
13 involuntarily converted (within the meaning of Section 1033 of
14 the Internal Revenue Code) and the transferor intends to acquire
15 property similar or related in service or use so as to be eligible
16 for nonrecognition of gain for California income tax purposes
17 under Section 1033 of the Internal Revenue Code.

18 (iv) The transaction will result in either a net loss or a net gain
19 not required to be recognized for California income or franchise
20 tax purposes.

21 (v) The transferor is a corporation with a permanent place of
22 business in California.

23 (E) (i) In the case of any transaction otherwise subject to this
24 subdivision that qualifies as an “installment sale” (within the
25 meaning of Section 453(b) of the Internal Revenue Code) for
26 California income tax purposes, the provisions of this subdivision
27 may, upon the irrevocable written election of the transferee, be
28 separately applied to each principal payment to be made under
29 the terms of the installment sale agreement between the parties.

30 (ii) For purposes of clause (i), subparagraph (A) of paragraph
31 (3) does not apply to each individual payment to be received
32 under the terms of the installment sale agreement.

33 (iii) The election under this subparagraph shall be made at the
34 time, and in the form and manner, specified by the Franchise Tax
35 Board in forms and instructions, except that the form shall, at a
36 minimum, include the requirement specified in clause (iv) of this
37 subparagraph.

38 (iv) The election under this subparagraph is valid only if the
39 transferee agrees to withhold and remit from each installment

1 payment the amount specified under this subdivision in the form
2 and manner, and at the time, specified in paragraph (4).

3 (4) (A) Amounts withheld and payments made in accordance
4 with this subdivision shall be reported and remitted to the
5 Franchise Tax Board in the form and manner and at the time
6 specified by the Franchise Tax Board. Notwithstanding the
7 foregoing, funds withheld on individual transactions by real
8 estate escrow persons may, at the option of the real estate escrow
9 person, be remitted by the 20th day of the month following the
10 close of escrow for the individual transaction, or may be remitted
11 on a monthly basis in combination with other transactions closed
12 during that month.

13 (B) The transferor shall submit a copy of the written certificate
14 specified in subparagraph (D) of paragraph (3), executed by the
15 transferor, to the Franchise Tax Board upon request.

16 (5) For purposes of this subdivision, “California real property
17 interest” means an interest in real property located in California
18 and defined in Section 897(c)(1)(A)(i) of the Internal Revenue
19 Code.

20 (6) For purposes of this subdivision, “real estate escrow
21 person” means any of the following persons involved in the real
22 estate transaction:

23 (A) The person (including any attorney, escrow company, or
24 title company) responsible for closing the transaction.

25 (B) If no person described in subparagraph (A) is responsible
26 for closing the transaction, then any other person who receives
27 and disburses the consideration or value for the interest or
28 property conveyed.

29 (7) (A) Unless the real estate escrow person provides
30 “assistance,” it shall be unlawful for any real estate escrow
31 person to charge any customer for complying with the
32 requirements of this subdivision.

33 (B) For purposes of this paragraph, “assistance” includes, but
34 is not limited to, helping the parties clarify with the Franchise
35 Tax Board the issue of whether withholding is required under
36 this subdivision or, upon request of the parties, withholding an
37 amount under this subdivision and remitting that amount to the
38 Franchise Tax Board.

1 (C) For purposes of this paragraph, “assistance” does not
2 include providing the written notification of the withholding
3 requirements of this subdivision.

4 (D) In a case where the real estate escrow person provides
5 “assistance” in complying with the withholding requirements of
6 this subdivision, it shall be unlawful for the real estate escrow
7 person to charge any customer a fee that exceeds forty-five
8 dollars (\$45).

9 (8) For purposes of this subdivision, “sales price” means the
10 sum of all of the following:

11 (A) The cash paid, or to be paid, but excluding for this purpose
12 any stated or unstated interest or original issue discount (as
13 determined under Sections 1271 through 1275, inclusive, of the
14 Internal Revenue Code).

15 (B) The fair market value of other property transferred, or to
16 be transferred.

17 (C) The outstanding amount of any liability assumed by the
18 transferee or to which the California real property interest is
19 subject immediately before and after the transfer.

20 (9) The Franchise Tax Board may prescribe, by forms,
21 instructions, published notices, or regulations, any requirements
22 necessary for the efficient administration of this subdivision
23 relating to the treatment of “de minimus” amounts otherwise
24 required under this section.

25 (f) Whenever any person has withheld any amount pursuant to
26 this section, the amount so withheld shall be held in trust for the
27 State of California. The amount of the fund shall be assessed,
28 collected, and paid in the same manner and subject to the same
29 provisions and limitations (including penalties) as are applicable
30 with respect to the taxes imposed by Part 10 (commencing with
31 Section 17001), Part 11 (commencing with Section 23001), or
32 this part.

33 (g) Withholding is not required under this section with respect
34 to wages, salaries, fees, or other compensation paid by a
35 corporation for services performed in California for that
36 corporation to a nonresident corporate director for director
37 services, including attendance at a board of directors’ meeting.

38 (h) In the case of any payment described in subdivision (g),
39 the person making the payment shall do each of the following:

1 (1) File a return with the Franchise Tax Board at the time and
2 in the form and manner specified by the Franchise Tax Board.

3 (2) Provide the payee with a statement at the time and in the
4 form and manner specified by the Franchise Tax Board.

5 (i) (1) The amendments to this section made by Chapter 488
6 of the Statutes of 2002 apply to dispositions of California real
7 property interests that occur on or after January 1, 2003.

8 (2) In the case of any payments received on or after January 1,
9 2003, pursuant to an installment sale agreement relating to a
10 disposition occurring before January 1, 2003, the amendments to
11 this section made by Chapter 488 of the Statutes of 2002 do not
12 apply to those payments.

13 SEC. 2. Section 18666 of the Revenue and Taxation Code is
14 amended to read:

15 18666. (a) Section 1446 of the Internal Revenue Code shall
16 apply to the extent that the amounts represent income from
17 California sources, except as otherwise provided.

18 (b) (1) The rate of tax referred to in Section 1446(b)(2)(A) of
19 the Internal Revenue Code shall be the maximum tax rate
20 specified in Section 17041, rather than the rate specified in
21 Section 1 of the Internal Revenue Code.

22 (2) The rate of tax referred to in Section 1446(b)(2)(B) of the
23 Internal Revenue Code shall be the rate specified in Section
24 23151, 23181, or 23183, as applicable, rather than the rate
25 specified in Section 11 of the Internal Revenue Code.

26 (c) The penalty for failure to withhold any amount required to
27 be withheld under this section shall be determined in accordance
28 with subdivision (a) of Section 18668.

29 SEC. 3. Section 18668 of the Revenue and Taxation Code is
30 amended to read:

31 18668. (a) Every person required under this article to deduct
32 and withhold any tax is hereby made liable for that tax, to the
33 extent provided by this section and, insofar as they are not
34 inconsistent with this article, all the provisions of this part
35 relating to penalties, interest, assessment, and collections shall
36 apply to persons subject to this part, and for these purposes any
37 amount required to be deducted and paid to the Franchise Tax
38 Board under this article shall be considered the tax of the person.
39 Unless it is shown that the failure to withhold is due to
40 reasonable cause, any person who fails to withhold from any

1 payments any amount required to be withheld under this article is
2 subject to a penalty for each failure in the amount equal to the
3 greater of the following:

4 (1) Five hundred dollars (\$500).

5 (2) Ten percent of the difference between the amount withheld
6 and submitted to the Franchise Tax Board and the amount
7 required to be withheld and submitted to the Franchise Tax
8 Board.

9 (b) If any amount required to be withheld under this article is
10 not paid to the Franchise Tax Board on or before the due date
11 required by regulations, interest shall be assessed at the adjusted
12 annual rate established pursuant to Section 19521, computed
13 from the due date to the date paid.

14 (c) Whenever any person has withheld any amount pursuant to
15 this article, the amount so withheld shall be held to be a special
16 fund in trust for the State of California.

17 ~~(d) In lieu of the amount provided for in subdivision (a),
18 unless it is shown that the failure to withhold is due to reasonable
19 cause, whenever any transferee is required to withhold any
20 amount pursuant to subdivision (e) of Section 18662, the
21 transferee is liable for the greater of the following amounts for
22 failure to withhold only after the transferee, as specified, is
23 notified in writing of the requirements under subdivision (e) of
24 Section 18662:~~

25 ~~(1) Five hundred dollars (\$500).~~

26 ~~(2) Ten percent of the amount required to be withheld under
27 subdivision (e) of Section 18662.~~

28 ~~(e) (1) Unless it is shown that the failure to notify is due to
29 reasonable cause, the real estate escrow person is liable for the
30 amount specified in subdivision (d), when written notification of
31 the withholding requirements of subdivision (e) of Section 18662
32 is not provided to the transferee (other than a transferee that is an
33 intermediary or accommodator in a deferred exchange) and the
34 California real property disposition is subject to withholding
35 under subdivision (e) of Section 18662.~~

36 ~~(2)~~

37 *(d) Whenever any transferee is required to withhold any*
38 *amount pursuant to subdivision (e) of Section 18662, the*
39 *transferee is liable for the amounts and penalty described in*
40 *subdivision (a).*

1 (e) (1) The real estate escrow person shall provide written
2 notification to the transferee (other than a transferee that is an
3 intermediary or accommodator in a deferred exchange) in
4 substantially the same form as follows:

5 “In accordance with Section 18662 of the Revenue and
6 Taxation Code, a buyer may be required to withhold an amount
7 equal to $3\frac{1}{3}$ percent of the sales price in the case of a disposition
8 of California real property interest by either:

9 1. A seller who is an individual, trust, or estate or when the
10 disbursement instructions authorize the proceeds to be sent to a
11 financial intermediary of the seller, OR

12 2. A corporate seller that has no permanent place of business
13 in California immediately after the transfer of title to the
14 California real property.

15 The buyer may become subject to penalty for failure to
16 withhold an amount equal to the greater of 10 percent of the
17 amount required to be withheld or five hundred dollars (\$500).

18 However, notwithstanding any other provision included in the
19 California statutes referenced above, no buyer will be required to
20 withhold any amount or be subject to penalty for failure to
21 withhold if:

22 1. The sales price of the California real property conveyed
23 does not exceed one hundred thousand dollars (\$100,000), OR

24 2. The seller executes a written certificate, under the penalty of
25 perjury, certifying that the seller is a corporation with a
26 permanent place of business in California, OR

27 3. The seller, who is an individual, trust, estate or a
28 corporation without a permanent place of business in California
29 executes a written certificate, under the penalty of perjury, of any
30 of the following:

31 A. The California real property being conveyed is the seller’s
32 or decedent’s principal residence (within the meaning of Section
33 121 of the Internal Revenue Code).

34 B. The last use of the property being conveyed was use by
35 the transferor as the transferor’s principal residence within the
36 meaning of Section 121 of the Internal Revenue Code.

37 C. The California real property being conveyed is or will be
38 exchanged for property of like kind (within the meaning of
39 Section 1031 of the Internal Revenue Code), but only to the
40 extent of the amount of gain not required to be recognized for

1 California income tax purposes under Section 1031 of the
2 Internal Revenue Code.

3 D. The California real property has been compulsorily or
4 involuntarily converted (within the meaning of Section 1033 of
5 the Internal Revenue Code) and that the seller intends to acquire
6 property similar or related in service or use so as to be eligible
7 for nonrecognition of gain for California income tax purposes
8 under Section 1033 of the Internal Revenue Code.

9 E. The California real property transaction will result in a loss
10 or a net gain not required to be recognized for California income
11 tax purposes.

12 The seller is subject to penalty for knowingly filing a
13 fraudulent certificate for the purpose of avoiding the withholding
14 requirement.”

15 ~~(3) The real estate escrow person is not liable under this~~
16 ~~subdivision if the tax due as a result of the disposition of~~
17 ~~California real property is paid by the original or extended due~~
18 ~~date of the transferor's return for the taxable year in which the~~
19 ~~disposition occurred.~~

20 (4)

21 (2) The real estate escrow person or transferee is not liable
22 under ~~paragraph (1) or subdivision (d)~~ *subdivision (a)*, if the
23 failure to withhold is the result of his or her reliance, based on
24 good faith and on all the information of which he or she has
25 knowledge, upon a written certificate executed by the transferor
26 under penalty of perjury pursuant to subparagraph (D) of
27 paragraph (3) of subdivision (e) of Section 18662.

28 ~~(5)~~

29 (3) Any transferor who for the purpose of avoiding the
30 withholding requirements of subdivision (e) of Section 18662
31 knowingly executes a false certificate pursuant to that section is
32 liable for twice the amount specified in subdivision ~~(d)~~ *(a)*.

33 (f) The amount of tax required to be deducted and withheld
34 under this article shall be assessed, collected, and paid in the
35 same manner and subject to the same provisions and limitations
36 (including penalties) as are applicable with respect to the taxes
37 imposed by Part 10 (commencing with Section 17001) or Part 11
38 (commencing with Section 23001).

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